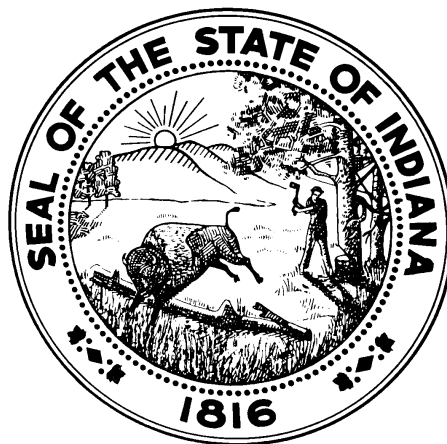


STATE BOARD OF ACCOUNTS
302 West Washington Street
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INDIANAPOLIS, INDIANA 46204-2769

AUDIT REPORT
OF

HARRISON COUNTY HOSPITAL
A COMPONENT UNIT OF
HARRISON COUNTY, INDIANA

January 1, 2007 to December 31, 2007



FILED
07/08/2008

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Hospital Officials	2
Independent Auditor's Report	3
Management's Discussion and Analysis.....	4-14
Basic Financial Statements:	
Statement of Net Assets.....	15
Statement of Revenues, Expenses, and Changes in Net Assets	16
Statement of Cash Flows - Restricted and Unrestricted Funds	17
Notes to Financial Statements	18-33
Exit Conference.....	34

HOSPITAL OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Chief Executive Officer	Steven L. Taylor	01-01-07 to 12-31-08
Chief Financial Officer	Jeffrey L. Davis	01-01-07 to 12-31-08
Chairman of the Hospital Board	Paul Martin	01-01-07 to 12-31-08
President of the Board of County Commissioners	James Goldman	01-01-07 to 12-31-08



STATE OF INDIANA

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INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF HARRISON COUNTY HOSPITAL, HARRISON COUNTY, INDIANA

We have audited the accompanying basic financial statements of Harrison County Hospital (Hospital), and its aggregate discretely presented component unit as of and for the year ended December 31, 2007, as listed in the Table of Contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Hospital and its aggregate discretely presented component unit as of December 31, 2007, and the respective changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States.

The Management Discussion and Analysis, as listed in the Table of Contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

STATE BOARD OF ACCOUNTS

June 17, 2008

HARRISON COUNTY HOSPITAL

Management Discussion and Analysis (MD&A)

This section of Harrison County Hospital's (HCH) annual financial statements presents background information and management discussion and analysis of the HCH financial performance for the year ended December 31, 2007. HCH reports results on a fiscal year of January 1 to December 31, and any reference to a year in this MD&A indicates the HCH fiscal years. This MD&A does not include a discussion and analysis of the activities and results of the Harrison County Hospital Foundation.

This MD&A should be read together with the financial statements and accompanying Notes to the Financial Statements included in this report.

Fiscal Year Change

HCH changed fiscal years for financial reporting purposes as of January 1, 2006. HCH previously reported on a fiscal year of October 1 to September 30, and now reports on a fiscal year of January 1 to December 31. The last fiscal year ended September 30 was 2005, with a short fiscal year reported for October 1, 2005 to December 31, 2005.

The decision to change the fiscal year was based on the desire of the hospital to align with the financial reporting of the governmental unit of Harrison County, and with the financial reporting of other industry entities. HCH also believes that the calendar year is more representative of the hospital's natural annual business cycle than the fiscal year ending September 30.

Financial Highlights

- HCH net assets increased by \$5,211,855 in 2007, resulting from operating gains of \$3,451,540, contributed capital of \$655,000 and non-operating revenue of \$1,105,315. The contributed capital includes \$575,000 funded by HCH into Harrison MOB LLC, a discreet component unit of HCH.
- Total net patient revenue, net of provision for bad debt, increased by 1%, while operating expenses increased by 8.4%. Net operating income for the year was \$3,451,540, a decrease of 39.8% from 2006.
- Long term debt, including current maturities, is \$30,042,445. This amount consists of \$30,000,000 in revenue bonds payable for the new hospital construction, and \$42,445 payable that has been drawn on the medical office building construction loan. Principal payments on the revenue bonds will begin in October 2008.
- The Board of Trustees gave approval in September of 2005 for HCH to make application for the critical access hospital (CAH) designation. HCH was approved

as a CAH facility as of December 15, 2005. The CAH program under Medicare was developed to assist smaller hospitals that service rural areas and areas of critical need, as it provides alternative reimbursement methods for patient services. Under the CAH program, Medicare will reimburse HCH at 101% of the allowable costs of providing services to Medicare patients.

- Construction began in late 2005 and was completed in February 2008 on the \$50 million replacement hospital facility. The funding was provided by: \$30 million in variable rate revenue bonds, backed by a five year letter of credit commitment from J.P. Morgan Chase Bank, and issued through the Indiana Health and Educational Facility Finance Authority; a contribution from Harrison County of \$12 million, which was funded from the sharing of gaming tax revenue; a grant from the Harrison County Community Foundation of \$5 million; HCH cash reserves of \$3 million. The revenue bonds were sold in November of 2005. Following the sale of the revenue bonds, HCH entered into an interest rate SWAP covering \$25 million of the \$30 million bond issue. The SWAP effectively fixes the interest rate at 3.81% for the life of those bonds. The grants were made in scheduled payments to HCH in September 2005, FY 2006 and FY 2007. Following is a general breakdown of the project costs:

* Land	\$686,000
* Site Work and Building Construction	32,154,000
* Equipment (original plan)	9,300,000
* Equipment Added – MRI and CT Scan	2,200,000
* Architectural Design Fees	1,960,000
* Engineers, Consultants, Planners	1,226,000
* Bond Issuance Expenses	589,000
* Construction Period Interest	980,000
* Build-out for Tenant – Dialysis Ctr.	400,000
* Other	<u>305,000</u>
Total	<u>\$49,800,000</u>

HCH has been researching the feasibility of, and planning for a new facility for a number of years. The primary reasons for building the replacement hospital are:

1. To replace an ageing and outdated facility, dating to 1950
2. Increased patient volumes have created the need for more space
3. To enhance functional areas for patient services, patient access, equipment, building and safety codes
4. The cost to build a new replacement facility is favorable in comparison to renovating the old structure
5. Relocating to a new site will provide greater visibility, better access to major roads, and room for future expansion
6. To allow HCH to remain competitive in the development of medical staff and new services

As of December 31, 2007, HCH has spent \$40,506,700 in construction costs for the new facility. The project was completed at a total cost of approximately \$49.8 million and the facility was placed into service during February 2008.

- In July 2006 HCH entered into an agreement with several physicians and healthcare providers to establish Harrison MOB, LLC. This entity was formed to invest in and operate a new medical office building to be located on the campus of the new HCH facility. HCH invested \$1,155,000 and which includes ownership of approximately 55% of the shares of the LLC. As of December 31, 2007 total assets of the LLC were \$2,429,895, and the limited activity of the LLC is included in the Financial Statements. The LLC began construction on the medical office building in 2007, with construction to be completed in late 2008. The total construction costs are estimated at \$7,225,000, with \$6,000,000 to be financed with a bank loan. More financial information on the LLC and the bank note is included in the Notes to the Financial Statements.
- In April 2008 the Harrison County Commissioners and the Board of Trustees formed an agreement to construct an ambulance station on the hospital campus, which will replace the ambulance station on the vacated hospital campus. The building will be an asset of the hospital. The estimated total cost of the building is \$1,000,000, with \$260,000 of the cost to be contributed by HCH and the balance to be funded by contributed capital from Harrison County. Construction of the building is to begin in 2008.
- In May 2008 the Harrison County Commissioners and the Board of Trustees approved the transfer of certain HCH land and buildings to Harrison County. The property to be transferred consists of the land and improvements, hospital buildings and medical office buildings that were taken out of service with the move to the new campus. The transfer is expected to take place on July 1, 2008. The properties carry an original cost of \$14,022,099, and will have on June 30, 2008, total accumulated depreciation of \$10,420,773, leaving a book value of \$3,601,326. The resulting loss on disposal of the properties will be treated as an extraordinary item in the 2008 financial statements. The decision to transfer the property rather than selling it on the open market was based on the following factors:
 1. The property has limited resale potential in the Harrison County market and is expensive to maintain as a property for sale
 2. Harrison County is an affiliated governmental unit and has a current shortage of space for county offices
 3. Harrison County supported the construction of the new hospital facility with a sizeable contribution of capital
 4. The transfer to the County will promote the long term utilization and maintenance of the property, which is a benefit to the community

- HCH continues to implement an upgraded and expanded hospital information system. Current projects include the implementation of electronic medical records systems, which will capture and store patient medical records in an electronic format. This is a significant investment in technology which improves quality of information for clinical and financial management, which in turn will facilitate improved quality of care. The enhanced information systems will also allow for operational efficiencies as patient volumes increase, and will be vital in conforming to regulatory requirements which continue to expand in number and complexity.

The Financial Statements

The HCH financial statements consist of - a Statement of Net Assets, a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These statements provide short-term and long-term financial information.

The Statement of Net Assets and Statement of Revenues, Expenses, and Changes in Net Assets provide information on the HCH resources and its activities. These two statements report the net assets of HCH and its changes. Increases or decreases of the HCH net assets are one indicator of whether its financial health is improving or eroding. However, other non-financial factors such as changes in economic conditions, population growth, patient demographic changes, and new or changed government legislation should also be considered.

The Statement of Net Assets includes all of the HCH assets and liabilities, and the net assets, which can be thought of as the net worth of HCH. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the financial results of the HCH operations and presents revenue earned and expenses incurred. The other primary financial statement is the Statement of Cash Flows. This statement provides information about HCH sources and uses of cash during the year, and the cash flows from operating activities, capital and related financing activities, and investing activities.

A summary of the HCH Balance Sheets as of December 31, 2007 and 2006 is presented below, in 000's:

	2007	2006	\$ Change	% Change
Assets:				
Cash and Investments	\$10,263	\$15,741	(\$5,478)	(34.8%)
Capital Assets	53,290	32,181	21,109	65.6%
Other Assets	10,519	9,241	1,278	13.8%
Restricted Assets - Cash	16,345	22,892	(6,547)	(28.6%)
Restricted Assets - Receivable	<u>0</u>	<u>5,587</u>	<u>(5,587)</u>	N/A
Total Assets	<u><u>\$90,417</u></u>	<u><u>\$85,642</u></u>	<u><u>\$4,775</u></u>	5.6%
Liabilities:				
Long Term Debt Outstanding	\$29,448	\$30,000	(\$552)	(1.8%)
Current and Other Liabilities	<u>6,446</u>	<u>6,330</u>	<u>116</u>	1.8%
Total Liabilities	<u><u>35,894</u></u>	<u><u>36,330</u></u>	<u><u>(436)</u></u>	(1.2%)
Net Assets:				
Invested in Capital Assets - Net of Related Debt	22,855	11,138	11,717	105.2%
Unrestricted	31,522	20,179	11,343	56.2%
Restricted	<u>146</u>	<u>17,995</u>	<u>(17,849)</u>	(99.2%)
Total Net Assets	<u><u>54,523</u></u>	<u><u>49,312</u></u>	<u><u>5,211</u></u>	10.6%
Total Liabilities and Net Assets	<u><u>\$90,417</u></u>	<u><u>\$85,642</u></u>	<u><u>\$4,775</u></u>	5.6%

The decrease in cash and investments and restricted cash, and the increase in capital assets is the result of the use of cash for the hospital construction project. The use of cash was offset somewhat by operating gains which generated positive cash flow from operations. Collections and reimbursements for patient services provided the primary source of cash.

Capital Assets have increased due to the construction in progress of the new \$50 million hospital facility.

A summary of the HCH Statement of Operations and Changes in Net Assets as of December 31, 2007 and 2006 is presented below, in 000's:

	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Revenue:				
Net Patient Service Revenue, net of provision for Bad Debt: 2007 (\$4,712); 2006 (\$4,398)	\$35,180	\$34,820	\$360	1.0%
Other	<u>1,319</u>	<u>1,409</u>	<u>(90)</u>	(6.4%)
Total Operating Revenue	<u>36,499</u>	<u>36,229</u>	<u>270</u>	0.7%
Expenses:				
Salaries and Benefits	18,740	17,352	1,388	8.0%
Medical Supplies and Drugs	3,311	3,364	(53)	(1.6%)
Depreciation and Amortization	2,118	1,952	166	8.5%
Other	<u>8,878</u>	<u>7,830</u>	<u>1,048</u>	13.4%
Total Operating Expenses	<u>33,047</u>	<u>30,498</u>	<u>2,549</u>	8.4%
Operating Income	3,452	5,731	(2,279)	(39.8%)
Non-Operating Revenue	1,117	640	477	74.5%
Non-Operating Expense	<u>(12)</u>	<u>(164)</u>	<u>152</u>	(92.7%)
Excess of Revenue over Expenses	4,557	6,207	(1,650)	(26.6%)
Capital Grants and Contributions	655	1,304	(649)	(49.8%)
Total Net Assets - Beginning of Year	<u>49,311</u>	<u>41,800</u>	<u>7,511</u>	18.0%
Total Net Assets - End of Year	<u>\$54,523</u>	<u>\$49,311</u>	<u>\$5,212</u>	10.6%

Sources of Revenue

During 2007 and 2006 HCH derived substantially all of its revenue from patient service and other related programs. Revenue is received from Medicare and Medicaid programs, self pay patients, insurance carriers, preferred provider organizations, and managed care companies. Other revenue includes payments from Harrison County for the operation of the county ambulance service, totaling \$828,710 in 2007 and \$936,868 in 2006.

The following table presents the percentages of gross revenue for patient services, by payor, for the years ended December 31, 2007 and 2006, respectively.

Payor	2007	2006
Medicare	44.8%	43.5%
Medicaid	10.7%	11.3%
Anthem	16.7%	15.3%
Commercial Insurance	6.5%	7.3%
Managed Care	12.8%	15.0%
Self Pay	5.6%	5.0%
Other	2.9%	2.6%
Total	100.0%	100.0%

Operating and Financial Performance

The financial operating performance of HCH receded in 2007 compared to the prior year. This section will discuss the highlights of 2007 operations and changes in activity.

Revenue

Net patient revenue increased only slightly during 2007 primarily as a result of a decrease in inpatient volumes, offset in part with an overall rate increase on services and a slight increase in outpatient volumes. Further discussion of revenue activity follows.

- Overall outpatient visits to HCH increased by 3% in 2007. Contributing to this rise was an increase in emergency room visits, and the increased demand for diagnostic testing as the industry continues to rely more on these procedures for detection and diagnosis of disease and injuries.
- Inpatient activity decreased in terms of patient days by 8%. This decrease reflects mild cold, flu and allergy seasons in 2007, which resulted in fewer elderly and chronically ill patients requiring acute care. Historical inpatient activity remains flat, which reflects the continued shift in the industry from inpatient services to outpatient services, as technology improves to allow less invasive procedures and shorten the time of recovery.
- The portion of deductions from gross revenue recognized by HCH for uninsured care and charity care in 2007 was \$6.2 million, or 7.8% of gross revenue, compared to \$5.9 million, or 7.7% of gross revenue in 2006. Uninsured care is included in provision for bad debt expense and represents uncollected charges for services not covered by insurance, and for patients that do not have health

insurance. Charity care is recognized as a deduction from gross revenue, and represents charges written off that were incurred in providing care to uninsured and indigent patients. HCH has a policy and a commitment to provide emergency care to all patients without regard for their ability to pay for services. Over the past several years there has been a trend of increasing uninsured care. This can be attributed to the overall local economy and the health insurance industry climate, which has left more of the population without health insurance. In addition, those with health insurance often face significant increases in patient deductibles and co-insurance as companies try to offset large health insurance premium increases by shifting toward consumer driven health plans.

- During 2007 net Medicare settlements of \$836,814 were received for the years 2006 and 2005, relating to the Medicare cost reports for those years. Under the Critical Access Hospital program, estimated interim payments are made by Medicare during the year, and then an initial settlement is made based on the cost report. The cost report determines the allowable cost of providing service to Medicare patients. The cost reports are then subject to subsequent reviews and audits, which may adjust the payment received or made on the initial settlement.
- Settlements of \$1,615,121 were received in 2007 under the Indiana Medicaid program, relating to the State of Indiana's fiscal years of 2004 and 2005. These payments were made as part of the Disproportionate Share Hospital program, and are recorded as offsets to revenue adjustments in the HCH accounting records. These payments were made from funds that are available to partially cover the hospital's cost of care to Medicaid and uninsured patients. These amounts are determined by the State through subsequent reviews and audits.

Expenses

Total operating expenses increased by 8.4% in 2007. Factors that had an impact on expenses are discussed below.

- Salaries and benefits costs for 2007 increased by \$1,388,000, an 8% increase from 2006. This increase was in line with budgeted projections and reflected an increase in employed physicians and their office staff; slight increases in labor for rising volumes of outpatient services; and the current high inflation indexes associated with healthcare labor and benefits costs.
- All expenses other than salaries and benefits rose by \$1,161,000, an increase of 8.8% from 2006. Expenses for depreciation and amortization increased by \$166,000 over 2006. This increase is due to the investment in new equipment in order to stay current with advancing technologies. In addition, professional fees increased \$394,000, reflecting higher costs for emergency room physicians. Purchased services increased \$584,000, due to additional expenses for contracted services in the areas of bad debt recovery and facility transition planning.

Long Term Debt

At fiscal year end 2007, HCH had total notes payable of \$30 million, a slight decrease from \$30.6 million at year end 2006. The \$30 million balance primarily represents revenue bonds that HCH issued for the construction of the new hospital facility. Interest payments are currently being made on these bonds, with principal payments scheduled to begin in November 2008. The principal amount due on the revenue bonds in 2008 is \$575,000. More detailed information on HCH's long term debt is presented in the Notes to the Financial Statements.

CAPITAL ASSETS

During 2007 HCH invested \$23.2 million in various capital assets. A summary of the capital assets is presented below, in 000's:

	<u>2007</u>	<u>2006</u>	<u>\$ Change</u>	<u>% Change</u>
Land and Land Improvements	\$1,762	\$1,772	(\$10)	(0.6%)
Buildings and Fixed Equipment	15,187	15,048	139	0.9%
Equipment	<u>13,609</u>	<u>13,483</u>	<u>126</u>	<u>0.9%</u>
Total Capital Assets	<u>30,558</u>	<u>30,303</u>	<u>255</u>	<u>0.8%</u>
Less Accumulated Depreciation	(20,621)	(20,307)	(314)	1.5%
Construction in Progress	<u>43,353</u>	<u>22,185</u>	<u>21,168</u>	<u>95.4%</u>
Capital Assets - Net	<u><u>\$53,290</u></u>	<u><u>\$32,181</u></u>	<u><u>\$21,109</u></u>	<u><u>65.6%</u></u>

HCH continues to invest in capital equipment in order to meet the needs of the service area population. These capital improvements result in increased service capacity, greater efficiencies, and upgraded technology. Additionally, HCH continues to replace equipment as it becomes obsolete, as well as upgrade the capabilities of the hospital information systems. The large increase in Construction in Progress in 2007 is due to construction capital costs associated with the replacement hospital building project.

In connection with the move to a new hospital campus, certain capital assets will be retired or disposed of in 2008. A summary of those assets is presented below, in 000's.

	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Book Value 06/30/08</u>
To be Transferred to Harrison County:			
Land and Land Improvements	\$597,394	\$541,964	\$55,430
Buildings	<u>13,424,705</u>	<u>9,878,809</u>	<u>3,545,896</u>
Totals	<u>\$14,022,099</u>	<u>\$10,420,773</u>	<u>\$3,601,326</u>
Retained from Former Campus:			
Land and Land Improvements	\$446,248	\$261,753	\$184,495
Buildings	<u>646,135</u>	<u>361,247</u>	<u>284,888</u>
Totals	<u>\$1,092,383</u>	<u>\$623,000</u>	<u>\$469,383</u>

The market value for the assets held for sale has not been determined as of the date of this report. These assets consist of single story physician office buildings and an EMS office and garage, as well as the land and improvements connected with these structures. The final disposition of these properties has not been determined as of the date of this report.

In addition, MRI equipment which was an operating lease buyout was sold for \$327,500 in 2008, which will be recognized as a loss on disposal of \$301,064. Other equipment and furnishings which have minimal book value will be donated or sold at auction in 2008.

The table below shows HCH's 2008 capital budget with projected spending of \$17.6 million for capital projects. Equipment to be placed in service in 2008 will be purchased from operating cash and cash reserves. Capital expenditures for the hospital building project will be funded from the proceeds of revenue bonds. The medical office building project is to be funded with a \$6 million bank loan and contributed cash from investors. The emergency medical services building will be funded with a \$740,000 grant from Harrison County and \$260,000 from HCH cash reserves.

Capital Budget (in 000's)	2008
Replacement Equipment	\$1,065
Information Systems	1,540
New Hospital	6,495
Medical Office Building	7,460
EMS Building	<u>1,000</u>
Total Capital Budget	<u><u>\$17,560</u></u>

More information on HCH's capital assets is presented in the Notes to the Financial Statements.

Economic and Industry Factors for 2008 Budget

The HCH Board of Trustees and management considered many factors when setting the 2008 budget. Of primary importance in setting the budget was the status of the economy and industry trends, which takes into account market forces and regulatory factors such as the following items:

- Population growth, demographic shifts, and the expanding need for services
- Continuously increasing expectations for quality improvement
- Advances in medical equipment technology and the need to replace obsolete equipment
- Privacy legislation – Health Insurance Portability and Accountability Act (HIPAA)
- Increasing emphasis on the integrity of public financial information
- Growing number of uninsured and underinsured patients
- Increasing costs of labor, medical supplies and drugs, and insurance
- Access to additional capital, and management of cash and debt levels
- Cash and resource requirements needed for the replacement hospital building project

The focus of management is to implement a multi-year plan that will consider expanded services, continuous quality improvement, cost control, capital requirements, and financing in support of net asset improvement.

Contacting HCH's Financial Manager

This report is designed to provide our citizens, customers, and creditors with a general overview of HCH's finances and to demonstrate accountability. If you have questions about this report or need additional information, contact the Chief Financial Officer, Jeffrey L. Davis at 812-738-4251.

HARRISON COUNTY HOSPITAL
STATEMENT OF NET ASSETS
December 31, 2007

<u>Assets</u>	<u>Primary Government</u>	<u>Discrete Component Units</u>	<u>Total Reporting Entity</u>
Current assets:			
Cash and cash equivalents	\$ 2,221,287	\$ 41,473	\$ 2,262,760
Short-term investments	8,000,000	-	8,000,000
Patient accounts receivable, net of estimated uncollectibles of \$5,953,392	4,297,598	-	4,297,598
Estimated third-party settlements	1,264,987	-	1,264,987
Supplies and other current assets	2,936,978	32,361	2,969,339
Noncurrent cash and investments:			
Internally designated	5,106,979	-	5,106,979
Held by trustee for construction	11,043,282	48,715	11,091,997
Restricted by contributors and grantors	145,687	-	145,687
Capital assets:			
Land and construction in progress	42,143,367	2,104,672	44,248,039
Depreciable capital assets, net of accumulated depreciation	9,042,161	-	9,042,161
Other assets:			
Investment in affiliated company	1,322,311		1,322,311
Other	462,417	202,674	665,091
Total assets	\$ 87,987,054	\$ 2,429,895	\$ 90,416,949
<u>Liabilities and Net Assets</u>			
Current liabilities:			
Current maturities of long-term debt	\$ 575,000	\$ 19,773	\$ 594,773
Accounts payable and accrued expenses	4,754,738	572,307	5,327,045
Other current liabilities	379,119	145,222	524,341
Long-term debt, net of current maturities	29,425,000	22,672	29,447,672
Total liabilities	35,133,857	759,974	35,893,831
Net assets:			
Invested in capital assets, net of related debt	21,185,528	1,669,921	22,855,449
Restricted:			
Expendable for capital acquisitions	145,687	-	145,687
Unrestricted	31,521,982	-	31,521,982
Total net assets	52,853,197	1,669,921	54,523,118
Total liabilities and net assets	\$ 87,987,054	\$ 2,429,895	\$ 90,416,949

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Year Ended December 31, 2007

	Primary Government	Discrete Component Units	Total Reporting Entity
Operating revenues:			
Net patient service revenue (net of provision for bad debt)	\$ 35,179,441	\$ -	\$ 35,179,441
Other	<u>1,319,428</u>	<u>-</u>	<u>1,319,428</u>
Total operating revenues	<u>36,498,869</u>	<u>-</u>	<u>36,498,869</u>
Operating expenses:			
Salaries and benefits	18,739,583	-	18,739,583
Professional fees and purchased services	6,400,366	-	6,400,366
Medical supplies and drugs	3,311,074	-	3,311,074
Insurance	590,271	-	590,271
Other supplies	1,216,762	-	1,216,762
Depreciation and amortization	2,103,599	13,942	2,117,541
Other	<u>671,732</u>	<u>-</u>	<u>671,732</u>
Total operating expenses	<u>33,033,387</u>	<u>13,942</u>	<u>33,047,329</u>
Operating income (loss)	<u>3,465,482</u>	<u>(13,942)</u>	<u>3,451,540</u>
Nonoperating revenues (expenses):			
Investment income	901,366	47,832	949,198
Interest expense	(12,010)	-	(12,010)
Noncapital grants and contributions	134,918	-	134,918
Gain on sale of equipment	<u>33,209</u>	<u>-</u>	<u>33,209</u>
Total nonoperating revenues (expenses)	<u>1,057,483</u>	<u>47,832</u>	<u>1,105,315</u>
Excess of revenues over expenses before capital grants and contributions	4,522,965	33,890	4,556,855
Capital grants and contributions	<u>80,000</u>	<u>575,000</u>	<u>655,000</u>
Increase in net assets	4,602,965	608,890	5,211,855
Net assets beginning of the year	<u>48,250,232</u>	<u>1,061,031</u>	<u>49,311,263</u>
Net assets end of the year	<u>\$ 52,853,197</u>	<u>\$ 1,669,921</u>	<u>\$ 54,523,118</u>

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
STATEMENT OF CASH FLOWS - RESTRICTED AND UNRESTRICTED FUNDS
Year Ended December 31, 2007

Cash flows from operating activities:	
Receipts from and on behalf of patients	\$ 35,705,909
Payments to suppliers and contractors	(12,864,758)
Payments to employees	(18,655,788)
Other receipts and payments, net	<u>87,963</u>
Net cash provided by operating activities	<u>4,273,326</u>
Cash flows from noncapital financing activities:	
Noncapital grants and contributions	<u>134,918</u>
Cash flows from capital and related financing activities:	
Capital grants and contributions	5,666,666
Proceeds from sale of assets	68,640
Principal paid on long-term debt	(589,783)
Interest paid on long-term debt	(12,010)
Purchase of capital assets	<u>(21,124,970)</u>
Net cash used by capital and related financing activities	<u>(15,991,457)</u>
Cash flows from investing activities:	
Interest and dividends on investments	892,480
Purchase of investments	(5,000,000)
Proceeds from sale of investments	11,822,983
Investment in affiliated company	<u>(575,000)</u>
Net cash provided by investing activities	<u>7,140,463</u>
Net decrease in cash and cash equivalents	(4,442,750)
Cash and cash equivalents at beginning of year	<u>8,880,569</u>
Cash and cash equivalents at end of year	<u><u>\$ 4,437,819</u></u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents in current assets	\$ 2,221,287
Internally designated cash and cash equivalents	2,070,845
Restricted cash and cash equivalents	<u>145,687</u>
Total cash and cash equivalents	<u><u>\$ 4,437,819</u></u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 3,465,482
Adjustments to reconcile operating income to net cash flows provided in operating activities:	
Depreciation and amortization	2,103,599
Provision for bad debts	4,712,394
Increase in current assets:	
Patient accounts receivable	(4,185,926)
Estimated third-party payor settlements	(560,239)
Supplies and other current assets	(655,256)
Increase (decrease) in current liabilities:	
Accounts payable and accrued expenses	(652,178)
Other current liabilities	<u>45,450</u>
Net cash provided by operating activities	<u><u>\$ 4,273,326</u></u>
Noncash investing, capital, and financing activities:	
The Hospital received pledges totaling \$5,666,666 with a present value adjustment of \$80,000.	

The accompanying notes are an integral part of the financial statements.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

Harrison County Hospital (Hospital) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The Hospital provides short-term inpatient and out-patient health care.

The Board of County Commissioners of Harrison County appoints the Governing Board of the Hospital and a financial benefit/burden relationship exists between the County and the Hospital. For these reasons, the Hospital is considered a component unit of Harrison County.

The accompanying financial statements present the activities of the Hospital (primary government) and its significant component unit. The component unit discussed below is included in the Hospital's reporting entity because of the significance of their operational or financial relationships with the Hospital. Blended component units, although legally separate entities, are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government. Discretely presented component units are involved in activities of an operational nature independent from the government; their transactions are reported in a separate column in the basic financial statements to emphasize that it is legally separate from the Hospital.

Discretely Presented Component Unit

The Harrison MOB, LLC, was created on July 26, 2006, and is a significant component unit of the Hospital. The Harrison MOB, LLC, is fiscally dependent on the primary government.

The financial statements of the individual component unit may be obtained from their respective offices as follows:

Harrison County Hospital
1141 Hospital Drive NW
Corydon, Indiana 47112

B. Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

C. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments

Cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Short-term investments are investments with remaining maturities of up to 90 days.

Statutes authorize the Hospital to invest in interest-bearing deposit accounts, passbook savings accounts, certificates of deposit, money market deposit accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Nonparticipating certificates of deposit, demand deposits, and similar nonparticipating negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost.

Debt securities are reported at fair value. Debt securities are defined as securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Money market investments that mature within one year or less at the date of their acquisition are reported at amortized cost. Other money market investments are reported at fair value.

Investments in affiliated companies are reported using the equity method of accounting, or at cost, as applicable.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

2. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Capital Assets

Capital assets, which include land, land improvements, buildings and fixed equipment, and equipment, are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets reported in the financial statements are as follows:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

	<u>Capitalization Threshold</u>	<u>Depreciation Method</u>	<u>Estimated Useful Life</u>
Land	\$ 1,000	Not applicable	Not applicable
Land improvements	1,000	Straight-line	AHA guide
Buildings and fixed equipment	1,000	Straight-line	AHA guide
Equipment	1,000	Straight-line	AHA guide

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. The total interest expense capitalized by the Hospital during the current year was \$409,663. The total interest expense capitalized by the discrete component unit during the current year was \$987.

4. Net Assets

Net assets of the Hospital are classified in three components.

Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures, discussed in Note II.G.

Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net assets of the discrete component unit are classified in one component.

Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

D. Grants and Contributions

From time to time, the Hospital receives grants from Harrison County and the State of Indiana as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

From time to time, the Harrison MOB, LLC, receives contributions from Harrison County Hospital, individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

E. Restricted Resources

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

F. Operating Revenues and Expenses

The Hospital's Statement of Revenues, Expenses and Changes in Net Assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Hospital's principal activity. Nonexchange revenues, including grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

G. Compensated Absences

The Hospital's policy on paid days off (which includes vacation, sick leave, personal leave and holidays) allows full-time employees and regular part-time employees to accrue paid days off, to a maximum of 60 days.

Paid days off are accrued when incurred and reported as a liability.

II. Detailed Notes

A. Deposits and Investments

1. Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 16-22-3-16 requires only that money in the hospital funds be deposited in the manner determined by the governing board. The Hospital does not have a formal policy regarding custodial credit risk for deposits. The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Custodial credit risk is the risk that, in the event of a bank failure, Harrison MOB, LLC's, deposits may not be returned to it. Harrison MOB, LLC, does not have a formal policy regarding custodial credit risk for deposits. The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Investments

As of December 31, 2007, the Hospital had the following investments:

Investment Type	Primary Government	Investment Maturities (in Years)		
	Market Value	Less Than 1	1-2	More Than 2
U.S. treasuries and securities	\$ 11,043,282	\$ 11,043,282	\$ -	\$ -

Statutory Authorization for Investments

Indiana Code 16-22-3-20 authorizes the Hospital to invest in: (1) any interest bearing account that is authorized to be set up and offered by a financial institution or brokerage firm registered and authorized to do business in Indiana; (2) repurchase or resale agreements involving the purchase and guaranteed resale of any interest bearing obligations issued or fully insured or guaranteed by the United States or any United States government agency in which type of agreement the amount of money must be fully collateralized by interest bearing obligations as determined by the current market value computed on the day the agreement is effective; (3) mutual funds offered by a financial institution or brokerage firm registered and authorized to do business in Indiana; (4) securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency; or (5) pooled fund investments for participating hospitals offered, managed, and administered by a financial institution or brokerage firm registered or authorized to do business in Indiana.

Investment Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Hospital does not have a formal investment policy for custodial credit risk for investments. At December 31, 2007, the Hospital did not hold investments with custodial credit risk.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Hospital's investments did not have credit risk.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a Hospital's investment in a single issuer. The Hospital does not have a policy in regards to concentration of credit risk. United States of America government and United States of America governmental agency securities are exempt from this policy requirement. The Hospital's investments did not have concentration of credit risk.

Foreign Currency Risk

The Hospital does not have a formal policy in regards to foreign currency risk.

B. Accounts Receivable and Payable

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at year end consisted of these amounts:

Patient Accounts Receivable

Receivable from patients and their insurance carriers	\$ 6,673,515
Receivable from Medicare	3,211,122
Receivable from Medicaid	<u>366,353</u>
Total patient accounts receivable	10,250,990
Less allowance for uncollectible amounts	<u>5,953,392</u>
Patient accounts receivable, net	<u><u>\$ 4,297,598</u></u>

Accounts Payable and Accrued Expenses

Payable to employees	\$ 649,352
Payable to suppliers	4,104,705
Other	<u>681</u>
Total accounts payable and accrued expenses	<u><u>\$ 4,754,738</u></u>

C. Capital Assets

Capital asset activity for the year ended December 31, 2007, was as follows:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 895,186	\$ -	\$ -	\$ 895,186
Construction in progress	<u>22,185,005</u>	<u>24,357,050</u>	<u>5,293,874</u>	<u>41,248,181</u>
Total capital assets, not being depreciated	<u>23,080,191</u>	<u>24,357,050</u>	<u>5,293,874</u>	<u>42,143,367</u>
Capital assets, being depreciated:				
Land improvements	876,629	-	9,528	867,101
Buildings and fixed equipment	15,048,040	173,242	34,580	15,186,702
Equipment	<u>13,483,016</u>	<u>1,930,377</u>	<u>1,804,105</u>	<u>13,609,288</u>
Totals	<u>29,407,685</u>	<u>2,103,619</u>	<u>1,848,213</u>	<u>29,663,091</u>
Less accumulated depreciation for:				
Land improvements	764,555	52,814	9,528	807,841
Buildings and fixed equipment	9,920,998	479,530	31,468	10,369,060
Equipment	<u>9,621,356</u>	<u>1,552,633</u>	<u>1,729,960</u>	<u>9,444,029</u>
Totals	<u>20,306,909</u>	<u>2,084,977</u>	<u>1,770,956</u>	<u>20,620,930</u>
Total capital assets, being depreciated, net	<u>9,100,776</u>	<u>18,642</u>	<u>77,257</u>	<u>9,042,161</u>
Total primary government capital assets, net	<u>\$ 32,180,967</u>	<u>\$ 24,375,692</u>	<u>\$ 5,371,131</u>	<u>\$ 51,185,528</u>
<u>Discretely Presented Component Unit</u>				
Capital assets, not being depreciated:				
Construction in progress	<u>\$ -</u>	<u>\$ 2,104,672</u>	<u>\$ -</u>	<u>\$ 2,104,672</u>

D. Construction Commitments

Construction work in progress is composed of the following:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

<u>Primary Government</u>	Total Project Authorized	Expended to December 31, 2007	Committed	Required Future Funding
<u>Project</u>				
Information systems	\$ 1,032,556	\$ 344,897	\$ 687,659	\$ -
New replacement hospital	36,625,000	33,927,404	2,697,596	-
New medical office building	179,151	179,151	-	-
Equipment	9,020,149	6,572,646	2,447,503	-
Building Improvement	417,300	224,083	193,217	-
Totals	<u>\$ 47,274,156</u>	<u>\$ 41,248,181</u>	<u>\$ 6,025,975</u>	<u>\$ -</u>

Discretely Presented Component Unit

<u>Project</u>				
New medical office building	<u>\$ 7,225,000</u>	<u>\$ 2,104,672</u>	<u>\$ 5,120,328</u>	<u>\$ -</u>

E. Leases

Operating Leases

The Hospital has entered into various operating leases having initial or remaining noncancelable terms exceeding one year for MRI equipment and office space. Rental expenditures for these leases were \$220,145 and \$60,261, respectively. The following is a schedule by years of future minimum rental payments as of year end:

2008	\$ 725,516
2009	<u>45,196</u>
Total	<u>\$ 770,712</u>

F. Long-Term Liabilities

1. Revenue Bonds

The Hospital issues bonds to be paid by income derived from the acquired or constructed assets. Revenue bonds outstanding at year end are as follows:

<u>Purpose</u>	<u>Interest Rates</u>	<u>Amount</u>
2005 Hospital construction revenue bonds	Variable	<u>\$ 30,000,000</u>

Disclosure information for the 2005 Revenue Bond Issue which includes interest rate swap agreements follows:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in November 2005, the Hospital entered into an interest rate swap in connection with its \$30,000,000 Series 2005 auction rate bond. The intention of the swap was to effectively change the Hospital's variable interest rate on the bond to a synthetic fixed rate of 3.55%.

Under the swap agreement, the Hospital pays the counterparty, U.S. Bancorp Piper Jaffray Financial Products Inc., a fixed payment of 3.81% and receives a variable payment computed as 70% of the London Interbank Offered Rate (LIBOR). The swap has equal notional amount totaling \$25,000,000 and the associated auction rate bonds have a \$25,000,000 principal amount. The swap was entered into at the same time the bonds were issued in November 2005. Beginning in 2008, the notional value of the swap begins to decline by \$575,000 and in increasing amounts in future years as the principal amount of the associated debt declines. The auction rate on the bonds closely approximates the Bond Market Association Municipal Swap Index (BMA). The bonds and related swap agreement mature on October 1, 2032. As of December 31, 2007, rates were as follows:

	Terms	Interest Rates (%)
Interest rate swap:		
Fixed payment to counterparty	Fixed	3.81%
Variable payment from counterparty	70% of LIBOR	3.70%
Net interest rate swap payments		0.11%
Variable auction-rate bond payments		3.63%
Synthetic interest rate of bonds		3.74%

As of December 31, 2007, the swap had a negative fair value of \$1,210,523. The negative fair value of the swap may be countered by reductions in total interest payments required by the auction rate bond, creating lower synthetic rates. Because the auction rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase.

As of December 31, 2007, the Hospital was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the Hospital would be exposed to credit risk in the amount of the derivative's fair value. The swap counterparty is currently rated A+ by Standard & Poor's, Aa3 by Moody's Investors Service and AA- by Fitch Ratings. The swap agreement does not contain collateral provisions for either party.

The swap exposes the Hospital to basis risk should the relationship between LIBOR and auction rates converge, changing the synthetic rate on the bonds. If a change occurs that results in the rate moving to convergence, the expected cost savings may not be realized.

The derivative contracts use the International Swaps and Derivatives Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedules to the Master Agreements include additional termination events. The swap may be terminated by the Hospital if the counterparty's credit rating falls below BBB- by Standard & Poor's, Aa3 by Moody's Investors Service or if either rating is withdrawn or

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

suspended. The counterparty may terminate the swap agreement if the Hospital's rating by Standard & Poor's falls below BBB- or the rating is withdrawn or suspended. Either party may terminate the swap if the other fails to perform under the terms of the contract. If the swap is terminated, the auction rate bonds would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the Hospital would be liable to the counterparty for a payment equal to the swap's fair value.

As of December 31, 2007, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their terms were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Year Ending December 31	Variable-Rate Bonds		Interest Rate Swap, Net	Total Debt Service
	Principal	Interest		
2008	\$ 575,000	\$ 1,104,681	\$ 32,842	\$ 1,712,523
2009	595,000	1,083,221	32,204	1,710,425
2010	675,000	1,060,466	31,527	1,766,993
2011	865,000	1,033,734	30,733	1,929,467
2012	895,000	1,001,451	29,773	1,926,224
2013-2017	4,985,000	4,481,024	133,220	9,599,244
2018-2022	5,935,000	3,482,116	103,522	9,520,638
2023-2027	7,065,000	2,293,029	68,171	9,426,200
2028-2032	8,410,000	877,363	26,084	9,313,447
Totals	<u>\$ 30,000,000</u>	<u>\$ 16,417,085</u>	<u>\$ 488,076</u>	<u>\$ 46,905,161</u>

2. Harrison MOB, LLC, Mortgage Loan Payable

Harrison MOB, LLC, (LLC) obtained a mortgage loan in June 2007 for an amount up to \$6,000,000, the final amount being determined by the actual costs of construction incurred. During the construction period of July 1, 2007 to December 31, 2008, a credit agreement is in place which calls for monthly interest payments based on the loan amount advanced. The interest is variable based on the daily London Interbank Offered Rate (LIBOR) plus 135 additional basis points during this period. As a measure to reduce the financing risk of the project until the building is completed and generating revenue, the Hospital is the guaranty of the loan during the construction period.

As of May 31, 2008, the amount of \$1,866,686 has been advanced on the loan, and construction period interest of \$7,538 has been paid by the LLC.

As a means to lower its borrowing costs, when compared against fixed-rate loans available in June 2007, the LLC entered into an interest rate swap in connection with \$5,600,000 of the final loan amount. The interest rate swap agreement is effective as of January 1, 2009, at the completion of the construction period. The intention of the swap was to effectively change the LLC's variable interest rate on the bond to a synthetic fixed rate of 7.16%.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Under the swap agreement, the LLC pays the counterparty, Regions Financial Corporation, a fixed payment of 7.16% and receives a variable payment computed as LIBOR. The swap has equal notional amount totaling \$5,600,000 and the associated mortgage loan will have a \$5,600,000 principal amount. The swap was entered into at the same time the mortgage loan was executed in June 2007. Beginning in 2009, the notional value of the swap begins to decline by \$92,380 and in increasing amounts in future years as the principal amount of the associated debt declines. The loan and related swap agreement matures on July 1, 2017. At that time the scheduled notional amount will be \$4,534.154, and the LLC will refinance all or part of the remaining amount.

The swap exposes the LLC to basis risk should the relationship between LIBOR and loan rates converge, changing the synthetic rate on the loan. If a change occurs that results in the rate moving to convergence, the expected cost savings may not be realized.

The derivative contracts use the International Swaps and Derivatives Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedules to the Master Agreements include certain additional termination events. Either party may terminate the swap if the other fails to perform under the terms of the contract. If the swap is terminated, the loan would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the LLC would be liable to the counterparty for a payment equal to the swap's fair value.

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2007, was as follows:

<u>Primary Government</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable:					
Revenue:					
Indiana Health and Educational					
Facility Financing Authority	\$ 30,000,000	\$ -	\$ -	\$ 30,000,000	\$ 575,000
Notes payable	589,783	-	589,783	-	-
	<u>\$ 30,589,783</u>	<u>\$ -</u>	<u>\$ 589,783</u>	<u>\$ 30,000,000</u>	<u>\$ 575,000</u>
Total long-term liabilities					
	<u>\$ 30,589,783</u>	<u>\$ -</u>	<u>\$ 589,783</u>	<u>\$ 30,000,000</u>	<u>\$ 575,000</u>
<u>Discretely Presented Component Unit</u>					
General long-term debt	\$ -	\$ 42,445	\$ -	\$ 42,445	\$ 19,773
	<u>\$ -</u>	<u>\$ 42,445</u>	<u>\$ -</u>	<u>\$ 42,445</u>	<u>\$ 19,773</u>

4. Net Revenue Available for Debt Service

The following disclosures concerning net revenue available for debt service applicable to the years ended December 31, 2007, are required by terms of the financing agreement between the Hospital and IHEFFA:

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Revenue from operations	\$ 35,179,441
Investment income	901,366
Net gain on disposal of assets	33,209
Less:	
Expenses (excluding depreciation, amortization and interest on funded debt)	<u>33,033,387</u>
Total net revenue available for debt service	<u>\$ 6,503,656</u>
Funded debt service for year	<u>\$ 1,739,430</u>
Historical debt service coverage ratio	<u>3:74</u>

G. Restricted Net Assets

Hospital restricted, expendable net assets are available for the following purposes:

	<u>2007</u>
Expendable for capital acquisitions	
Building and equipment	<u>\$ 145,687</u>

H. Charity Care

Charges excluded from revenue under the Hospital's charity care policy were \$1,508,941 for 2007.

I. Internally Designated Assets

Noncurrent cash and investments internally designated include the following:

Funded Depreciation - Amounts transferred from the Operating Fund by the Hospital Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the Hospital buildings as authorized by Indiana Code 16-22-3-13.

Internally designated:	
Funded depreciation:	
Cash and cash equivalents	\$ 2,070,845
Investments	3,000,000
Accrued interest receivable	<u>36,134</u>
Total internally designated	<u>\$ 5,106,979</u>

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

III. Other Information

A. Risk Management

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters.

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; and natural disasters are covered by commercial insurance from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance by major category of risk.

Medical Benefits to Employees and Dependents

The Hospital has chosen to establish a risk financing fund for risks associated with medical benefits to employees and dependents. The risk financing fund is accounted for in the General Fund where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of \$40,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amounts of payouts and other economic and social factors.

However, claim liabilities cannot be reasonably estimated.

B. Subsequent Events

The new hospital facility located at 1141 Hospital Drive, NW, Corydon, Indiana was completed and occupied on February 21, 2008. Capital assets purchased in 2008 include "buildings and fixed equipment" and "equipment" in the amounts of \$7,384,000 and \$3,241,000, respectively.

Hospital officials approved the donation of the old hospital facility and the old medical office buildings located at the campus at 245 Atwood Street to Harrison County, pending acceptance by County officials. The disposal of these facilities includes land, land improvements, and buildings, with a current book value of \$28,475, \$26,955, and \$3,545,897, respectively.

The Hospital is holding other capital assets associated with the Hospital campus located at 245 Atwood Street for sale. The market value of these assets has not been determined as of the report date. The book value of the assets as of June 30, 2008, is \$469,382.

The Hospital purchased a 1.5T MR System from GE Healthcare Financial Services, through an early buyout of a lease, for \$628,563.55 (remaining lease payments in the amount of \$348,563.55 plus \$280,000 which represented the fair market value of the equipment). The Hospital subsequently sold the asset for \$327,500.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

The Hospital approved the construction of a new Emergency Medical Services (EMS) facility on the campus at 1141 Hospital Drive, NW, Corydon, Indiana, with an estimated cost of \$1 million. The Hospital approved \$260,000 toward the funding of the facility with the remainder to be funded with contributions.

C. Contingent Liabilities

Litigation

The Hospital is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

D. Fair Value of Financial Instruments

The following methods and assumptions were used by the Hospital and its discrete component unit in estimating the fair value of its financial instruments:

Cash and Cash Equivalents

The carrying amount reported in the Statement of Net Assets for cash and cash equivalents approximates its fair value.

Investments

Fair values, which are the amounts reported in the Statement of Net Assets, are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

Accounts Payable and Accrued Expenses

The carrying amount reported in the Statement of Net Assets for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements

The carrying amount reported in the Statement of Net Assets for estimated third-party payor settlements approximates its fair value.

E. Investment in Affiliated Companies

Harrison-Floyd Health Services, LLC

In 2004, the Hospital entered into an agreement with Floyd Memorial Hospital and Health Services to establish and operate a limited liability company, Harrison-Floyd Health Services, LLC. In accordance with this agreement, each hospital invested \$150,000 for 50% equity interest in the LLC. The investment was made in the fiscal years 2004 and 2005. The LLC began operation in 2004. The investment is recorded on the equity method. The Hospital's investment in the affiliated company is included in the Other assets category of the Statement of Net Assets.

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

Summarized financial information as of December 31, 2007, and for the year then ended from the unaudited financial statements of the affiliated company follows:

Current assets	\$	35,724
Noncurrent assets		147,018
Current liabilities		14,583
Net assets		168,159
Revenue		85,600
Expenses		127,452
Net loss		41,852

Harrison MOB, LLC

On July 26, 2006, the Hospital entered into an agreement with several physicians and physician groups to establish and operate a medical office building to be located on the Hospital's campus in Corydon, Indiana, known as Harrison MOB, LLC. In accordance with this agreement, 68 Class A units and 37 Class B units were sold for \$10,000 each, for an aggregate proceeds of \$1,050,000. Each unit represents an equity interest of approximately .952% in the company. The Hospital purchased 58 units for an investment of \$580,000 representing approximately 55.2% equity interest in the company. To date the medical office building is not operational. The Hospital committed to lease available finished square footage in the building up to a 90% occupancy level for the first five years and up to 85% occupancy level for the next five years. The investment is recorded on the equity method. The Hospital's investment in the affiliated company is included in the Other assets category of the Statement of Net Assets.

On May 30, 2007, the Harrison MOB, LLC, agreed to borrow a maximum principal amount of \$6,000,000 from Regions Bank to acquire, construct and develop a 43,000 square-foot medical office building on the campus of Harrison County Hospital. The term of the loan will be 25 years. During the construction phase, the principal of and interest on the loan and all related costs, fees and other sums will be guaranteed by Harrison County Hospital.

Summarized financial information as of December 31, 2007, and for the year then ended from the audited financial statements of the affiliated company follows:

Current assets	\$	2,178,506
Noncurrent assets		251,389
Current liabilities		737,302
Noncurrent liabilities		22,672
Net assets		1,669,921
Revenues		47,832
Expenses		13,942
Net income		33,890

HARRISON COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
(Continued)

F. Pension Plan

Hospital Pension Plan

Plan Description

The Hospital has a defined contribution pension plan administered by MetLife as authorized by Indiana Code 16-22-3-11. The plan provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the Hospital Board of Trustees and the Plan Administrator. The Plan Administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. That report may be obtained by contacting:

MetLife
c/o FasCare LLC
P.O. Box 173768
Denver, Colorado 80217-3768
Ph. (800) 543-2520

Funding Policy and Annual Pension Cost

The contribution requirements of plan members are established by the written agreement between the Hospital Board of Trustees and the Plan Administrator. Plan members' contributions are voluntary and are established by written authorization for payroll deduction into an annuity savings account. The Hospital is required to contribute at an actuarially determined rate. The current rate is 5% of annual covered payroll. Employer and employee contributions to the plan for the year ending December 31, 2007 were \$539,350 and \$573,456, respectively.

HARRISON COUNTY HOSPITAL
EXIT CONFERENCE

The contents of this report were discussed on June 17, 2008, with Paul Martin, Chairman of the Hospital Board; Steven L. Taylor, Chief Executive Officer; Jeffrey L. Davis, Chief Financial Officer; and Keith M. Lieber, Controller. Our audit disclosed no material items that warrant comment at this time.